

# **Report of the auditor-general to the Free State Legislature and the council on the Nala Local Municipality**

## **Report on the financial statements**

### **Introduction**

1. I have audited the financial statements of the Nala local municipality set out on pages ... to ..., which comprise the statement of financial position as at 30 June 2016, the statement of financial performance, statement of changes in net assets, cash flow statement and the statement of comparison of budget and actual amounts for the year then ended, as well as the notes, comprising a summary of significant accounting policies and other explanatory information.

### **Accounting officer's responsibility for the financial statements**

2. The accounting officer is responsible for the preparation and fair presentation of these financial statements in accordance with the South African Standards of Generally Recognised Accounting Practice (SA Standards of GRAP) and the requirements of the Municipal Finance Management Act, 2003 (Act No. 56 of 2003) (MFMA) and the Division of Revenue Act, 2015 (Act No. 1 of 2015) (DoRA), and for such internal control as the accounting officer determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

### **Auditor-general's responsibility**

3. My responsibility is to express an opinion on these financial statements based on my audit. I conducted my audit in accordance with the International Standards on Auditing. Those standards require that I comply with ethical requirements, and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.
4. An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the municipality's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the municipality's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.
5. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my audit opinion.

## Opinion

6. In my opinion, the financial statements present fairly, in all material respects, the financial position of the Nala Local Municipality as at 30 June 2016 and its financial performance and cash flows, the statement for the year then ended, in accordance with SA Standards of GRAP and the requirements of the MFMA and DoRA.

## Emphasis of matters

7. I draw attention to the matters below. My opinion is not modified in respect of these matters.

## Restatement of corresponding figures

8. As disclosed in note 37 to the financial statements, the corresponding figures for 30 June 2015 have been restated as a result of errors discovered during 2015-16 in the financial statements of the municipality at, and for the year ended, 30 June 2015.

## Going concern

9. Note 39 to the financial statements indicates that the municipality had a deficit for the year ended 30 June 2016 and, as of that date, the municipality's current liabilities exceeded its current assets. The municipality owed Eskom R143 488 754 (2015: R92 131 196) and Sedibeng water R108 720 835 (2015: R86 405 624) as at 30 June 2016, which was long overdue. These and the other conditions disclosed indicate the existence of a material uncertainty that may cast significant doubt on the municipality's ability to meet its financial obligations as they fall due and to achieve service delivery objectives as outlined in the service delivery business implementation plan.

## Material losses

10. As disclosed in note 46 to the financial statements, material electricity and water losses of R14 542 628 (2015: R10 627 694) and R13 076 807 (2015: R12 403 814), respectively, were incurred as a result of line losses, tampering and theft.

## Material impairment

11. As disclosed in notes 4 and 5 to the financial statements, management provided for the impairment of consumer and other receivables of R355 164 556 (2015: R294 324 816).

## Irregular expenditure

12. As disclosed in note 42 to the financial statements, the municipality incurred irregular expenditure of R20 182 168 in 2015-16 (2015: R11 751 465) mainly due to non-compliance with supply chain management requirements.

## Fruitless and wasteful expenditure

13. As disclosed in note 41 to the financial statements, the municipality incurred fruitless and wasteful expenditure of R39 493 521 in 2015-16 (2015: R25 799 529) mainly due to interest paid on long outstanding debt.

## Additional matter

14. I draw attention to the matter below. My opinion is not modified in respect of this matter.

## Unaudited disclosure note

15. In terms of section 125(2)(e) of the MFMA the municipality is required to disclose particulars of non-compliance with the MFMA. This disclosure requirement did not form part of the audit of the financial statements and accordingly I do not express an opinion on it.

## Report on other legal and regulatory requirements

16. In accordance with the Public Audit Act, 2004 (Act No. 25 of 2004) (PAA) and the general notice issued in terms thereof, I have a responsibility to report findings on the reported performance information against predetermined objectives for selected key performance areas (KPA's) presented in the annual performance report, compliance with legislation and internal control. The objective of my tests was to identify reportable findings as described under each subheading but not to gather evidence to express assurance on these matters. Accordingly, I do not express an opinion or conclusion on them.

## Predetermined objectives

17. I performed procedures to obtain evidence about the usefulness and reliability of the reported performance information for the following selected KPA presented in the annual performance report of the municipality for the year ended 30 June 2016:
- KPA1: Basic service delivery on pages x to x
18. I evaluated the reported performance information against the overall criteria of usefulness and reliability.
19. I evaluated the usefulness of the reported performance information to determine whether it was consistent with the planned KPA. I further performed tests to determine whether indicators and targets were well defined, verifiable, specific, measurable, time bound and relevant, as required by the National Treasury's Framework for Managing Programme Performance Information (FMPPI).
20. I assessed the reliability of the reported performance information to determine whether it was valid, accurate and complete.

21. The material findings in respect of the selected KPA are as follows:

## **KPA 1: Basic service delivery**

### Usefulness of reported performance information

22. Section 41(c) of the Municipal Systems Act, 2000 (Act No. 32 of 2000) requires the integrated development plan to form the basis for the annual report, therefore requiring consistency of objectives, indicators and targets between planning and reporting documents. A total of 30% of the reported objectives were not consistent with those in the approved integrated development plan. This was because the municipality did not have a performance management system and standard operating procedures were not established.
23. The processes and systems that produced the indicator should be verifiable, as required by the FMPPI. A total of 30% of the indicators were not verifiable.

### Reliability of reported performance information

24. The FMPPI requires auditee's to have appropriate systems to collect, collate, verify and store performance information to ensure reliable reporting of actual achievements against planned objectives, indicators and targets. The reported achievements against planned targets of 46,7% of indicators were not reliable when compared to the source information or evidence provided.

## **Additional matter**

25. I draw attention to the following matter:

### Achievement of planned targets

26. Refer to the annual performance report on pages x to x for information on the achievement of planned targets for the year. This information should be considered in the context of the qualified conclusions expressed on the usefulness and reliability of the reported performance information for the selected KPA reported in paragraphs 21 to 23 of this report.

## **Compliance with legislation**

27. I performed procedures to obtain evidence that the municipality had complied with applicable legislation regarding financial matters, financial management and other related matters. My material findings on compliance with specific matters in key legislation, as set out in the general notice issued in terms of the PAA, are as follows:

## **Strategic planning and performance management**

28. The service delivery and budget implementation plan for implementing the municipality's delivery of municipal services and annual budget did not indicate capital expenditure by vote, as required by section 1 and 53(1)(c) of the MFMA.

## **Financial statements, performance and annual reports**

29. The financial statements submitted for auditing were not prepared in all material respects in accordance with the requirements of section 122 of the MFMA. Material misstatements of current assets, expenditure and disclosure notes identified by the auditors in the submitted financial statement were subsequently corrected, resulting in the financial statements receiving an unqualified audit opinion.
30. The 2014-15 annual report was not published for the local community to submit representations in connection with the annual report, as required by section 127(5)(a) of the MFMA.
31. The council failed to adopt an oversight report containing the council's comments on the annual report within the prescribed timelines, as required by section 129(1) of the MFMA.
32. The oversight report adopted by the council on the 2014-15 annual report was not made public, as required by section 129(3) of the MFMA.

## **Procurement and contract management**

33. Goods and services with a transaction value of below R200 000 were procured without obtaining the required price quotations as required by supply chain management (SCM) regulation 17(a) and (c).
34. Goods and services with a transaction value above R200 000 were procured without inviting competitive bids, as required by SCM regulation 19(a). Deviations were approved by the accounting officer even though it was not impractical to invite competitive bids, in contravention of SCM regulation 36(1).
35. A contract was awarded to bidders based on preference points that were not allocated in accordance with the requirements of the Preferential Procurement Policy Framework Act and its regulations.
36. Contracts and quotations were awarded to bidders who did not submit a declaration on whether they were employed by the state or connected to any person employed by the state, as required by SCM regulation 13(c).
37. The performance of contractors or providers was not monitored monthly, as required by section 116(2)(b) of the MFMA.
38. Contracts and quotations were awarded to providers whose tax matters had not been declared by the South African Revenue Service to be in order, as required by SCM regulation 43.

## **Human resource management and compensation**

39. The competencies of the chief financial officer, head of supply chain and financial and supply chain management officials were not assessed in a timely manner to identify and address gaps in competency levels, as required by the municipal regulations on minimum competency levels 13.



## **Expenditure management**

- 40. Money owed by the municipality was not always paid within 30 days as required by section 65(2)(e) of the MFMA.
- 41. Reasonable steps were not taken to prevent irregular and fruitless and wasteful expenditure, as required by section 62(1)(d) of the MFMA.

## **Asset management**

- 42. An effective system of internal control for assets was not in place, as required by section 63(2)(c) of the MFMA.

## **Internal control**

- 43. I considered internal control relevant to my audit of the financial statements, annual performance report and compliance with legislation. The matters reported below are limited to the significant internal control deficiencies that resulted in the findings on the annual performance report and the findings on compliance with legislation included in this report.

## **Leadership**

- 44. Leadership's implementation of recommendations from the previous management reports was slow, especially relating to oversight functions such as the audit committee and internal audit, which did not improve from the previous year.
- 45. Management had not implemented consequence management for a number of years to set the tone at the top that compliance with legal and ethical standards is a pre-requisite. This resulted in various non-compliance matters.
- 46. Human resource management was not effective in ensuring that competent and sufficiently skilled officials were appointed to ensure that performance is monitored.
- 47. The action plan process was not effective to timeously address financial and performance reporting matters and non-compliance that occurred during the financial year.

## **Financial and performance management**

- 48. During the year under review, management was slow to implement policies and procedures to regularly review and monitor compliance with legislation and performance information.
- 49. Management did not timeously ensure that all the previous year's audit recommendations were implemented, resulting in errors that had to be corrected, and non-compliance.

## **Governance**

50. Leadership responded slowly to appointing new audit committee members during the year, resulting in the audit committee's oversight not having any impact on the internal control environment of the municipality.
51. The internal audit unit has not been functional since its inception and a lack of consequence management, as well as vacancies in the audit committee for the majority of the year, contributed to the situation where the internal audit function did not have any impact on the internal control environment of the municipality.

## **Other reports**

## **Investigations**

52. The National Prosecuting Authority is investigating findings relating to procurement as contained in the report of the Public Protector of South Africa, issued during September 2010. The investigation was still on-going at the reporting date.

Auditor General

Bloemfontein

30 November 2016



AUDITOR - GENERAL  
SOUTH AFRICA

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